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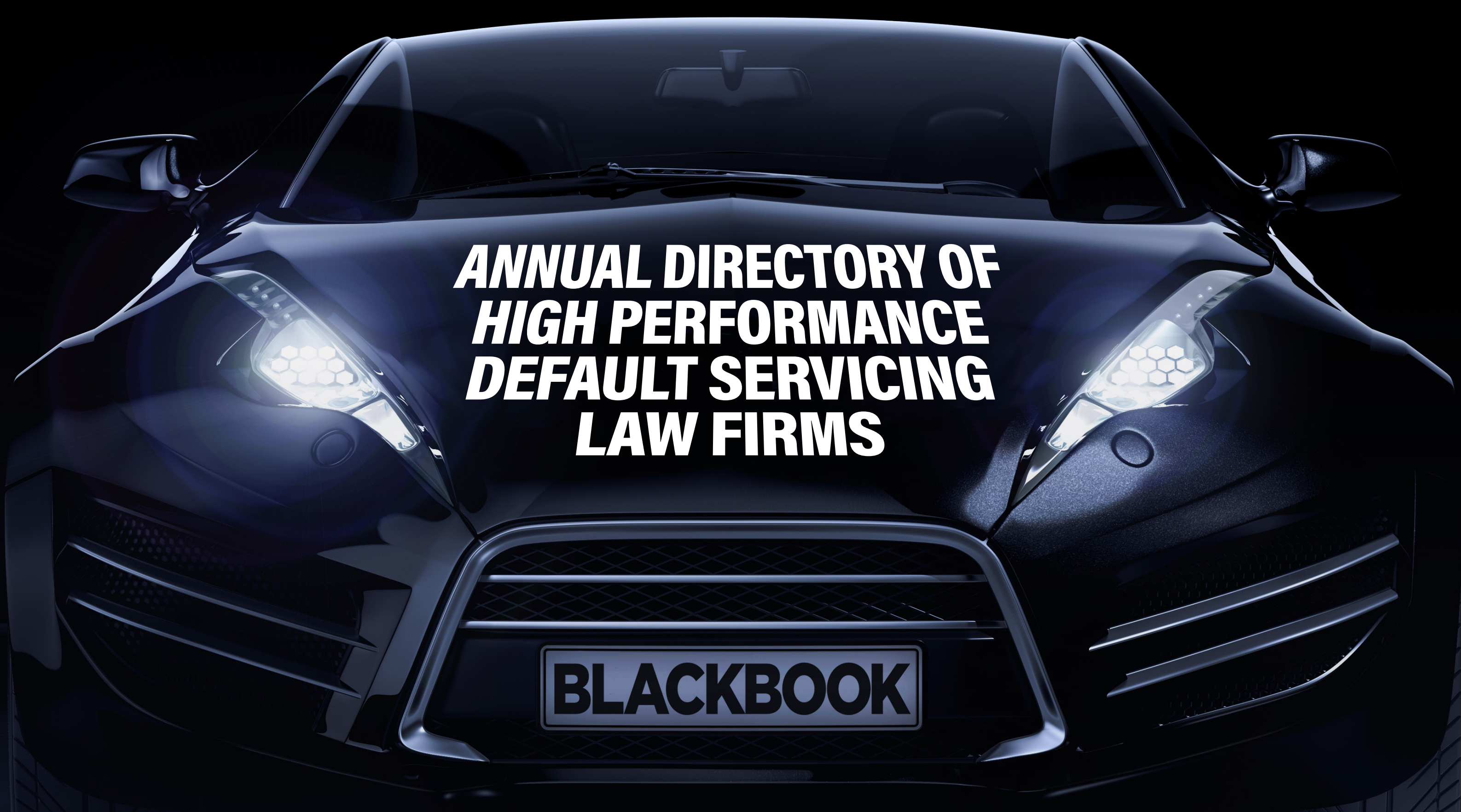

ANNUAL DIRECTORY OF HIGH PERFORMANCE DEFAULT SERVICING LAW FIRMS

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NATIONAL

PITFALLS FOR CREDITORS WHEN THE PLAN PAYS AN ESCROWED LOAN IN FULL

By Ashley Osborn, SouthLaw P.C.

A Chapter 13 plan that treats your creditor client's claim by paying it in full may appear at first glance to be a treatment that benefits both parties. If the note is already set to amortize within the life of the plan and the debtor is current, then treatment in the section of the plan for payment of claims in full is most appropriate because the treatment already aligns with the amortization schedule in the note. Similarly, if the property is non-residential, modifying the claim by paying it in full over the life of the plan is an option available to the debtor through the Code. However, when the plan treats the claim to be paid in full by the Chapter 13 trustee and the loan is also escrowed by the creditor, the result may be an outstanding balance at the end of the case if the proper precautions are not taken.

This situation arises when the plan proposes to either cram the claim down to the value of the property to be paid within the life of the plan or proposes to pay the total claim amount but crams down the amortization to within the five-year life of the plan rather than the amortization scheduled in the note. The creditor may not agree to the treatment in the first place after analyzing such factors as the proposed value, interest loss, change to amortization schedule, and whether or not the property is the debtor's residence. If the creditor does agree to the treatment, the escrow should be addressed at plan confirmation to prevent a mess down the road.

Many jurisdictional form plans do not provide a designated place for treatment of escrow for a pay in full claim (neither does the proposed Chapter 13 Official Form 113). Claims being paid in full through the plan are often seconds/HELOCs with no escrow accounts, so escrow is not an issue. But when the loan is escrowed and that escrow account is not treated, the trustee will not know to make payments to the creditor for escrow unless notified to do so. Even if the creditor files notices of payment change for escrow, they may go ignored if the trustee was not notified to pay the escrow. Considering that Rule 3002.1 does not apply to claims that are paid in full, the trustee may assume that filing them was a creditor error. The result is a loan that at the end of the case should be paid in full but still has a balance due to unpaid escrow.

Do you have to fix it and, if so, how? Instead of finding out, just object to the plan. Decide with your client if they want to continue to escrow and, if so, how the debtor will reimburse the creditor (notices of fees or notices of payment change work, even if Rule 3002.1 does not apply). Maybe your client wants to turn that obligation over to the debtor. Either way, put it into an agreed order on the objection to plan or have the debtor amend the plan to add the agreed-upon treatment so all parties are on notice. Continue to check in throughout the case to make sure that the escrow payments are being made by the trustee and/or that any escrow disbursements by the creditor are noticed to the trustee, debtor, and the court.

If your client does have an escrow balance at the end of the case on a pay-in-full loan, you may need to get creative in order to resolve. If the issue is caught early, the parties may agree to put any post-accrued escrow delinquency into an amended claim to be paid through the plan and set up a system for ongoing payments. The parties could agree to have the delinquency paid in a stipulated order over a period of several months outside the plan if the jurisdiction allows.

If the issue is caught at the end of the case, the parties may want to agree to put the remaining balance into a loan modification to be paid after the case closes. Leaving the issue unresolved will likely result in immediately defaulting the loan after the case closes. While this may be the only solution if the parties cannot agree to resolve, it may put the creditor back in bankruptcy court to determine the validity of the balance where the proportion of the creditor's fault may come into play. Cases in point are slim, but see In re Tavares, 547 B.R. 204 (Bankr. S.D. Tex. 2016). In Tavares, the debtor's schedules stated that she would pay her post-petition taxes directly. The creditor not only paid the taxes but also did not fully correct the misapplication of payments. Ultimately, the creditor could not recover the disbursements.